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MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 1, 2016/2017

BBF 2154 – INVESTMENT

(All sections / Groups)

21 OCTOBER 2016

3:00 – 5:00 p.m

(2 Hours)

INSTRUCTIONS TO STUDENT

1. This Question paper consists of 5 pages with 5 Questions only.
2. Attempt **FOUR** out of **FIVE** questions. All questions carry equal marks and the distribution of the marks for each question is given.
3. Students are allowed to use non-programmable scientific and financial calculators.
4. Please write all your answers in the Answer Booklet provided.

QUESTION 1

(a) You have invested in a bond that gives 12% coupon interest and the par value of the bond is RM1000. It is also currently priced at RM1200 with 12 years to maturity.

(i) Calculate the yield to maturity (YTM) of this bond. (6 marks)

ii) What would be the yield to call (YTC) if the call of the bond can be made in 6 years at a price of RM1030? (6 marks)

(b) Assume a stock is selling for RM48.50 with options available at 40, 50, and 60 strike prices. The 50 call option price is at RM2.75.

(i) What is the intrinsic value of the 50 call? (2 marks)

(ii) Is the 50 call in the money? Explain. (2 marks)

(iii) What is the speculative premium on the 50 call option? (3 marks)

(iv) What percentage of common stock price does the speculative premium represent? (2 marks)

(v) Are the 40 and 60 call options in the money? Explain. (4 marks)

(Total: 25 marks)

QUESTION 2

(a) DAEBAK Company anticipates the need to purchase 70,000 bushels of corns in six months to use in their products. The current cash price for corns is RM5.50 a bushel. A six-month futures contract for corns can be purchased at RM5.60.

(i) Discuss why DAEBAK Company might need to purchase futures contracts to hedge their position. (4 marks)

(ii) To completely hedge their exposure, how many contracts will they need to purchase if corns trade in 5,000-bushel contracts? (2 marks)

(iii) If the cash price of corns ends up at RM5.75 per bushel after six months, by how much will the actual cost of 70,000 bushels of corns have gone up? (5 marks)

(iv) After the futures contracts are closed out (sold at RM5.75), what will be the gain or loss on the futures contracts? (5 marks)

(v) What is the overall gain or loss considering the answer in part (iii) and part (iv)? (3 marks)

Continued ...

(b) You are a manager at a large manufacturing company and you have information that your earnings report is going to come in well below analyst expectations. Should you try to reveal the information to the financial markets? Why or why not? (3 marks)

(c) Explain the meaning of efficient frontier and discuss the relevance of the efficient frontier to the portfolio selection. (3 marks)

(Total: 25 marks)

QUESTION 3

(a) ROCKY Corporation foresees a non-constant growth pattern for dividends. Dividends at the end of year 1 are RM4.00 per share. The dividend are expected to grow 10% per year until the end of year 4 and 7% perpetual growth rate that. All dividends are to be discounted back to present at a discount rate of 15%.

(i) Estimate the dividend for year 2 until year 4. (3 marks)

(ii) Find the Net Present Value (NPV) for all dividends from year 1 until year 4.

(7 marks)

(iii) Find the dividend in year 5. (3 marks)

(iv) Find the present value of year 4 stock price. (5 marks)

(v) What is the total present value of ROCKY stock? (3 marks)

(b) Assume the real rate of return in Malaysian economy is 3%, the expected rate of inflation is 5%, and the risk premium is 6%. Compute the risk-free rate and required rate of return. (4 marks)

(Total: 25 marks)

Continued ...

QUESTION 4

(a) Ms Lynn owns a portfolio consisting of the following stocks:

Stock	Investment Amount	Beta	Expected return
Larrie	RM40,000	1.80	25%
Madeline	RM32,000	1.30	20%
Neptune	RM60,000	0.80	11%
Oroton	RM43,000	1.05	13%

The Treasury bill rate is 5% and the expected return on the market portfolio is 8%.

- (i) What is the expected return of the portfolio? (9 marks)
- (ii) Calculate the beta of the portfolio. (5 marks)
- (iii) Calculate the required rate of return. (3 marks)

(b) (i) Mr Starry buys 100 shares of stock Pawzyme at RM40 per share on margin 40%. If price increases to RM50 per share, what is his percentage gain or loss on initial equity? (4 marks)

(ii) What would be Mr Starry percentage gain or loss on initial equity if the price decreased to RM26? (4 marks)

(Total: 25 marks)

Continued ...

QUESTION 5**(a) Malaysia's monetary policy is effective, says Moody's**

By BERNAMA, 17 MARCH 2016.

KUALA LUMPUR: Malaysia's monetary policy is effective in ensuring adequate levels of liquidity, banking stability and low inflation, said Moody's Investors Service. The rating agency said the country's large domestic institutional investor base and net foreign assets also provided ample buffer against financial shocks. "Headline inflation averaged 2.6 per cent over the past decade, lower than similarly rated peers," it said in a note today. Although nearly 40 per cent of the country's price basket was subjected to administrative controls, inflation was more stable compared with other countries with similarly extensive subsidy framework like India, Indonesia and Qatar. "Over the last ten years, Malaysia demonstrated one of the lowest levels of inflation among the sovereign that we rate, and this situation has helped anchor domestic interest rates," it said. Moody's said in 2015, inflation remained under control at 2.1 per cent despite price pressures from the implementation of the Goods and Services Tax and exchange rate depreciation.

(Adopted from: New Straits Times Online:

<http://www.nst.com.my/news/2016/03/133373/malaysias-monetary-policy-effective-says-moodys>)

Central banks have typically used monetary policy to either stimulate an economy into faster growth or slow down growth over fears of issues like inflation. Contractionary monetary policy slows the rate of growth in the money supply or outright decreases the money supply in order to control inflation. Discuss **THREE (3)** ways that can help to reduce money supply in the economy. (12 marks)

(b) Do leading indicators tend to give longer warnings before peak or before trough? Discuss the differences between peak and trough. What is the implication for the investors? (5 marks)

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(c) CASH Corporation issued US dollar denominated five year discount note for US dollar 200 million. The proceeds were converted to Ringgit Malaysia to purchase capital equipment in Malaysia. The company wants to hedge this currency exposure and is considering the following alternatives:

- At-the-money US dollar call options
- US dollar futures

Discuss the essential characteristics of the two derivative instruments.

(8 marks)

(Total: 25 marks)

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